

Submission to Ofcom's consultation on the
BBC's Trading Activities

pact.

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Introduction

1. Pact is the UK trade association which represents and promotes the commercial interests of independent feature film, television, digital, children's and animation media companies.
2. The UK independent television sector is one of the biggest in the world. Despite the difficult economic climate, independent television sector revenues have grown to around £3 billion in 2015.¹
3. In 2015, the BBC spent £443 million on commissions from UK external producers which amounts to the equivalent of 46% of eligible television content from external producers².
4. BBC Commissions are important for independent producers as they account for 29% of all UK commissions, making the BBC the biggest buyer of content made by independent producers in the UK.³
5. Pact recognises the important role that the BBC plays in the UK television marketplace and how it nurtures and adds to the finely balanced TV production ecology in the UK. We are pleased by the positive trajectory of the new charter whereby the license fee has been secured for another 11 years. The BBC is a positive innovator and experimenter in the marketplace and this is often driven by the content which it commissions from independent production companies.
6. For further information, please contact Pact's Head of Policy, Emily Oyama, at emily@pact.co.uk or on 020 7380 8232

¹ Pact Census 2016

² BBC Annual Reports and Accounts 2015/16

³ Pact Census 2015

Trading activities requirements: consultation

Requirements for trading between the BBC Public Service and BBC commercial subsidiaries

Proposed requirements for trading between the BBC Public Service and third Parties

- 1.1 We acknowledge that Ofcom has already set out guidance and requirements that cover the commercial activities of the BBC and that this will also inform how the BBC Public Service will trade with their commercial subsidiaries and third parties.
- 1.2 Pact endorses the proposed requirements for trading between the BBC Public Service and third parties set out in this consultation.
- 1.3 We particularly agree with the requirement for the BBC to use open market prices via competitive tendering and where this isn't possible to set market prices based on verifiable comparable information. We also agree that if the BBC needs to resort to a cost based approach, they will need to ensure an overhead (which includes capital costs and appropriate contribution toward reinvestment) is included in the pricing as well as the relevant direct costs.
- 1.4 Pact would like to use this opportunity to raise the remaining outstanding issues with regards access to goods and services and transfer pricing. We have outlined our thoughts in our response below.

Access to Goods and Services

- 1.5 Pact calls on Ofcom to ensure there is no subsidising of activity via any BBC commercial subsidiaries' use of BBC group services. This could mean that the new BBC Subsidiary BBC Studios could undercut the market by taking advantage of lower prices offered by BBC Group which could subsequently allow the BBC commercial subsidiary to charge below market rate in its products.
- 1.6 We continue to question for example why there is a certain capacity being maintained in professional functions which remain embedded within BBC public service such as HR directly linked to BBC Studios. This will act as an indirect subsidy, especially if by using these services, BBC Studios is able to reduce its overall costs and improve its operating margins. The impact on achieving a 'level playing field' with Indies could be even more

acute in the nations where margins are arguably smaller. We believe the BBC should remove this capacity, and remove any other staff who are embedded in BBC public service with a direct line to BBC Studios. These staff should be TUPEd across to BBC Studios as required and form part of its own operating costs, as is consistent with other commercial companies. We ask Ofcom to question the efficiency and thinking behind maintaining this potential overcapacity within BBC public service. We are particularly interested in how Ofcom will scrutinise the flexibility BBC Studios will be given to procure services from the open market versus buying services from BBC Group. Ofcom must ensure that when it comes to the latter, BBC Studios proves that services were bought at fair market rates.

Transfer pricing

1.7 We continue to be concerned with the idea that the BBC can use shared services for their commercial subsidiaries and that Ofcom is relying on the transfer pricing system to ensure there is no cross subsidy. We believe there is still a risk posed in this area as we have issues with the BBC's transfer pricing arrangements and we have called for an early review of the arrangements. This is because we remain concerned about the lack of transparency in current transfer pricing arrangements which was most recently noted in the review by Ernst & Young⁴(EY). For example these included:

1.7.1 A lack of review of prices and cross checks: The BBC Trust had confirmed that the BBC will review periodically but did not commit to regular reviews.

1.7.2 The BBC does not track a list of relevant transfer pricing relationships.

1.7.3 There is no regular review system for all contracts.

1.8 Following this review, the BBC was given the opportunity to modify its practices ahead of the market having the opportunity to comment on its practices. In one area recommended for improvement by EY (on benchmarking) the BBC Trust was asked to publish more detailed guidance on what is considered a 'margin'. The Trust previously confirmed that this would be published internally from April 2017; this didn't allow us and other third parties to review ahead of the approval for BBC Studios. The effectiveness of the BBC's transfer pricing regime – both in principle and in practice – is a matter of significant concern to the market and it does not seem right to deny third parties the opportunity to express views

⁴ BBC Transfer Pricing Review, Ernst and Young, August 2016

on proposed actions before they were finalised. In some instances it continues to remain hard to quantify what the processes as much of the guidance remains for internal purposes only. For this reason we call on Ofcom to complete an early review of the BBC's transfer pricing arrangements.

- 1.9 We also continue to be concerned about the actions the BBC may or may not have taken with the pricing and terms of existing contracts for co-production and co-development deals. We would expect the transfer of existing programme contracts and consequent recharging tariffs to be consistent with market norms, i.e. the costs of a production plus a margin. We believe an early review of BBC Studios and the transfer pricing arrangements will help understand any issues that might occur. Although the BBC Trust approved the regulatory proposal for BBC Studios, it acknowledged that all future commissioning decisions between BBC Studios and the BBC public service would be subject to Studios implementing organisational structure effectively and adhering to the rules of operation. It also acknowledged that checks should be put in place to make sure that any commissioning decisions are in line with market practice and designed in a way that adheres to state aid rules.⁵ The review also considered it important that Ofcom 'undertakes a review and notes that any complaints could bring it forward'.⁶ For this reason we call on Ofcom to confirm that it will carry out a comprehensive review of Studios including the period just prior to Studios becoming commercialised.

⁵ BBC Trust, Regulatory decision on BBC Studios, p47-48, December 2016

⁶ BBC Trust, Regulatory decision on BBC Studios, p44, December 2016